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Report to the Honorable
John J. LaFalce

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HOME OWNERSHIP

Mortgage Servicing Transfers Are Increasing and Causing Borrower Concern

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General Accounting Office
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Resources, Community, and
Economic Development Division

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The Honorable John J. LaFalce
House of Representatives

Dear Mr. LaFalce:

As requested, we have reviewed the practice of mortgage servicing transfers common among many home mortgage lenders. Mortgage servicing is the function of collecting monthly payments of mortgage principal and interest, making payments to investors, administering escrow accounts, and performing other related activities. Mortgage institutions buy and sell mortgage servicing, sometimes as part of the sale of the mortgage itself and sometimes as a separate asset. Regardless of the circumstances surrounding the transfer of servicing, however, the borrower must deal with a new servicer following the transfer.

Because you expressed concern about problems created for borrowers whose mortgage servicing is transferred from one firm to another, we focused our review on the extent to which mortgage servicing is transferred, why the transfers occur, and what problems borrowers may experience when servicing is transferred. We reviewed actions taken by certain states, secondary mortgage market agencies, and others, and examined proposed federal legislation regarding the treatment of borrowers when mortgage servicing is transferred. Our review did not address possible benefits for borrowers that might result from the transfer of servicing.

Results in Brief

According to a leading broker of mortgage servicing, the volume of mortgage servicing transfers has increased in recent years, from an estimated $80 billion to $90 billion in 1985 to $150 billion in 1988.[1] The 1988 transfer volume represents 7 percent of the total $2.1 trillion mortgage debt outstanding at that time. Several factors, including economies of scale, accounting and tax advantages, and the need to generate income, make it profitable for firms to buy and sell servicing. For some borrowers, servicing transfers have caused frustration and inconvenience. Other borrowers have experienced problems of a more serious nature. How extensive these problems are remains unclear because no central clearinghouse or focal point exists to monitor such complaints.

[1]When industry participants report servicing transfer volumes, the dollar amount refers to the outstanding principal of the mortgages serviced.

Some actions to protect the borrower have been taken by states, secondary mortgage market agencies, and others. These actions include policies, guidance, and legislation requiring, among other things, that the borrower be notified of the transfer. H.R. 1180, which contains provisions similar to those in certain state statutes, was introduced in the 101st Congress.

Background

Two reasons that mortgage institutions interact with borrowers are to originate home mortgage loans and to service those loans. Origination covers all the activities necessary for a lender to lend money to a borrower in exchange for a mortgage lien against real property.

The originator of a mortgage (the lender) may choose to hold onto the mortgage note or sell it. Likewise, the lender may service the mortgage or sell the servicing to another party who will then service the mortgage. Servicing may be transferred as part of a sale of the mortgage note (referred to as selling the mortgage "servicing-released"), or it may be sold as a separate asset. Servicing may be transferred at any time during the life of the loan—even on the date of loan origination.

While the sale of the mortgage note itself may go unnoticed by borrowers, the sale of servicing must ultimately be brought to their attention because they must make monthly payments to the new servicer. Although the borrower has no choice in whether the servicing is retained by the original lender or sold to another firm, a change in servicers might make little difference to the borrower, provided that the transfer of servicing goes smoothly and the borrower is satisfied with the service provided by the new servicer.

Mortgage Servicing Transfers Are Increasing

In recent years, the volume of mortgage servicing transfers has increased. While no precise figures are available on the overall volume of servicing transfers, one of the principal brokers of mortgage servicing estimated that servicing was transferred on mortgages with outstanding principal of approximately $150 billion in 1988, up from an estimated $80 billion to $90 billion in 1985. Some of these servicing transfers were for mortgages that serve as collateral for mortgage-backed securities guaranteed by the Government National Mortgage Association (Ginnie

Mae).[1] According to Ginnie Mae officials, servicing transfers on these mortgages grew from about $13 billion in 1984 to over $62 billion in 1988. Industry participants predict that trading of mortgage servicing will remain strong. Appendix I provides more detailed data on the volume of mortgage servicing transfers.

Servicing May Be Transferred for a Variety of Reasons

Mortgage servicing changes hands because both sellers and buyers of servicing profit from the transfer. Servicing is sold to increase income and cash flow. By selling servicing, sellers realize income immediately rather than over the life of the mortgage. There are also certain accounting advantages to selling the servicing at the same time that the mortgage is sold. Firms buy servicing for the yield that it provides. A variety of factors, such as favorable tax treatment, access to monies held in escrow accounts, and economies of scale, make servicing a profitable venture. Appendix II discusses in detail the reasons that servicing is transferred.

Borrowers Can Be Adversely Affected by Transfers, but Extent of Problem Is Unknown

Mortgage servicing transfers can have adverse effects on borrowers. In our review of borrower complaints, we found that disputes can arise over escrow matters, such as large increases in escrow amounts and the servicers' nonpayment of taxes and insurance premiums; difficulty in communicating with the new servicers; and the unwarranted assessment of late fees.

No central clearinghouse exists to identify borrowers whose servicing was transferred or complaints related to servicing transfers. Thus, we were unable to determine how extensive transfer-related problems are among those whose servicing is transferred. Regulatory groups that receive complaints about servicing transfers generally categorize them by the type of problem involved (escrow matters, for example) rather than as a transfer problem. An examination of borrower complaints in the relevant categories revealed that these groups have received relatively few complaints related to servicing transfers.

Individual cases indicate that the problems borrowers associate with servicing transfers are frustrating and difficult to resolve. In a few

[1] Ginnie Mae, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation are the three organizations most often associated with the secondary residential mortgage market. All three organizations encourage investors to buy mortgages or securities representing a pool of mortgages by guaranteeing that the investors will be paid principal and interest from these mortgages even if the borrowers default.

cases, borrowers blamed the loss of their homes through foreclosure on events that they associated with the transfer of their servicing. Appendix III discusses the kinds of borrower problems related to servicing transfers and provides specific examples.

Actions Taken or Proposed to Address the Problem

At least 12 states have laws or regulations requiring, among other things, that servicers provide borrowers written notification of the transfer of servicing. The key provisions of these are summarized in appendix IV. The Federal Housing Administration (FHA) directs that, when servicing is transferred on an FHA-insured loan, the servicer provide the borrower 10 days advance notice prior to the payment due date. The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) have also established procedures to be followed by servicers who transfer servicing on loans in which Fannie Mae or Freddie Mac has an interest. These procedures require that both the buyer and the seller of the servicing notify the borrower that servicing is being transferred. In addition, the Mortgage Bankers Association of America has issued to its members servicing transfer guidelines similar to those issued by Freddie Mac and Fannie Mae, but adherence to these guidelines is voluntary.

H.R. 1180 would impose on servicers requirements similar to certain state laws governing servicing transfers. In addition to requiring servicers to notify borrowers of a transfer at least 10 days prior to the first payment affected by the transfer, H.R. 1180 would require that a loan originator tell a loan applicant what the originator's past transfer practices have been and whether the servicing on the applicant's mortgage will be subject to sale. Other requirements are included, and penalties are established for violation of the provisions. Although we are not providing a full assessment of H.R. 1180, the provisions of the bill appear to be a step toward dealing with the problems associated with mortgage servicing transfers on a wider basis than currently provided by state laws, regulations, and policies of entities concerned with servicing.

The information presented in this report was obtained from a variety of sources in both the public and private sectors, including officials in regulatory groups, secondary market agencies, trade associations, and other entities. We also reviewed state laws, agency regulations, and policies. Much of the information on reasons why servicing is bought and sold came from trade publications.

Much of the information on borrower complaints was taken from a group of letters sent to you in response to a syndicated column that discussed servicing transfers. Because this information is anecdotal, no generalizations can be drawn about the magnitude of the problem among all borrowers whose servicing is transferred.

Our review focused on borrower problems and did not include an examination of the benefits that may result from the transfer of mortgage servicing. For example, we did not examine whether mortgage loans are less expensive for the borrower because of servicing transfers, or whether, in some cases, servicing actually improves following a transfer of servicing. In addition, we did not determine whether the problems that were reported by borrowers whose servicing was transferred occur among borrowers whose servicing was not transferred, although we encountered some indications that they do. Appendix VII contains more detailed information on our objectives, scope, and methodology.

Our work was performed between February and October 1989. As requested, we did not obtain agency comments on a draft of this report; however, we did discuss its contents with agency officials who generally agreed with the information presented. Unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from the date of this letter. At that time, we will send copies to the Director of the Office of Management and Budget, the Secretary of Housing and Urban Development, and other interested parties. Copies will be available to others upon request. Should you need further information, please contact me at (202) 275-5525.

Major contributors to this report are listed in appendix VIII.

Sincerely yours,

John M. Ols, Jr.

John M. Ols, Jr.
Director, Housing and Community
Development Issues

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Abbreviations

FHA	Federal Housing Administration
GAO	General Accounting Office
FTC	Federal Trade Commission

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Mortgage Servicing Transfers Are Increasing

In recent years an active secondary market for mortgage servicing has developed. Although precise data are not available, some industry experts characterize the increase in servicing transfers as "an explosion" in transfer volume. Estimates of overall transfer volume, data provided by the Government National Mortgage Association (Ginnie Mae), and other evidence support this characterization.

Overall Transfer Volume Is Increasing

Overall servicing transfer volume is increasing, but precise data on the amount of servicing transferred are not available. However, one of the leading brokers of mortgage servicing provided us estimates of overall trading volume for the years 1985 through 1988. As shown in table I.1, overall servicing transfer volume has increased from an estimated $80 billion to $90 billion in 1985 to an estimated $150 billion in 1988.

Table I.1: Value of Mortgages for Which Servicing Was Transferred

Dollars in billions

Year	Value
1985	$80–$90
1986	$100
1987	$120
1988	$150

To put these data into perspective, other statistics on mortgage loan activity need to be considered. During 1988, when servicing transfer volume was an estimated $150 billion, mortgages valued at $412 billion were originated, $326 billion in mortgages were traded in the secondary mortgage market, and total mortgage debt outstanding was $2.1 trillion.

It should be noted that data on the overall volume of servicing transfers are considered to be "soft." A recent trade journal reported one servicing broker as having said that "'It's such a private market that it would be difficult to estimate the total volume.'"[1] Brokers who are willing to make educated guesses about overall market activity do so on the basis of what they know about Ginnie Mae activity, their own transactions, and what they believe to be their own share of the market. Other published estimates are similar to those provided in table I.1; however, it is possible that the same estimates are being cited time after time and have gained credibility by virtue of repetition. We did not independently verify the estimates shown in table I.1.

[1] "$150 Billion Industry", United States Banker, Dec. 1988, p. 14.

Transfers of Ginnie Mae Servicing Have Increased

The best data available on the volume of servicing transfers are for mortgages that serve as collateral for mortgage-backed securities issued by Ginnie Mae. Ginnie Mae refers to servicing transfers to as "transfers of issuer responsibility." Table I.2 shows the volume of these transfers for the years 1984 through 1988 and the first 7 months of 1989. These transfers represent a portion of the total transfer activity shown in table I.1.

Table I.2: Transfers of Issuer Responsibility

Dollars in billions

Year	Value
1984	$13.1
1985	$24.6
1986	$24.7
1987	$42.7
1988	$62.1
1989[a]	$39.0

[a]Jan. through Aug. 1

Source: Ginnie Mae

Other Indications of Servicing Transfer Growth

Other evidence suggests that servicing transfer volume is on the increase. One indication is the increase in the number of servicing brokers and consultants, software packages for transfers, and models for determining the value of servicing. In addition, Standard & Poor's Corporation, a leading publisher of business and financial information, has reportedly begun rating lenders on loan servicing and origination—a move that is expected to facilitate servicing transfers by providing information about the quality of a servicing portfolio.

Transfer Volume Is Expected to Remain Strong

Regardless of the precise trading volume, the general outlook is that transfer volume will continue to be strong. However, short-term decreases in transfer activity could occur. For example, according to trade publications, servicing sales declined during the Congress' recent consideration of thrift industry reform because of the uncertainty about how purchased and retained servicing rights would be counted toward meeting newly established capital requirements for savings associations.[2] In the House version of the bill, retained servicing would have been treated in the same manner as purchased servicing. The final version, however, addresses only purchased servicing, specifically that it

[2]The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (P.L. 101-73).

will be counted (at 90 percent of its fair market value) toward the new capital requirements for savings associations. The law is silent on the treatment of retained servicing toward meeting capital requirements.

Many Factors Account for the Transfer of Mortgage Servicing

Competition in the mortgage market has increased and, as a result, lenders have begun to closely examine their operations for opportunities to enhance profitability. From this search, mortgage servicing has emerged as a important source of income and as a readily marketable financial asset.

Why are some firms so ready to part with this valuable asset? According to trade publications, there are a variety of reasons why firms buy and sell servicing. Essentially, firms buy or sell servicing because it is profitable for them to do so. Furthermore, sellers of servicing may become buyers of servicing, or vice versa, depending on the market.

Why Firms Sell Servicing

Servicing is sold to increase income and cash flow. By selling servicing, income is realized (in accounting terms, "recognized") immediately rather than spread out as monthly servicing income over the life of the mortgage. Selling mortgages servicing-released also has certain accounting advantages. In addition, many firms are only involved in loan originations and sell all the servicing they originate.

Servicing Sales Allow Income Recognition and Generate Cash Flow

The most obvious reason to sell servicing is to recognize income from the sale. When servicing is sold, the seller records the income on the closing date of the transaction. If, on the other hand, the originator keeps the servicing, a risk exists that servicing income from the account (which the servicer would recognize each month over the life of the loan) will cease if, for example, the loan is prepaid. By selling the servicing, such risk is passed on to someone else. The buyer of the servicing tries to consider such risks when determining a reasonable price for the servicing.

Firms may sell servicing just before the end of a financial reporting period so they can bolster income statements. This practice has become increasingly important because more lenders are publicly held companies and must report to stockholders. Industry observers note that servicing trading volume seems to pick up just before the end of financial reporting periods.

Servicing sales also seem to increase when higher interest rates reduce the demand for home mortgage loans. During these periods of reduced loan originations, servicing sales may be necessary to raise enough cash

to meet overhead costs and to avoid staff layoffs. In addition, competition in the housing finance industry has reduced the profits in loan origination so much that some lenders depend heavily on servicing sales. The Mortgage Bankers Association of America's 1987 survey of its members found that, for an average firm, loan origination costs exceeded origination income by almost $966 per loan. Thus, the profit for many lenders lies in the sale of the servicing.

Accounting Standards May Have Increased Servicing Transfers

While we identified no specific accounting rules that provide a direct incentive to sell mortgage servicing, technical guidance may have reduced the incentive to keep the servicing on mortgage notes sold. In addition, an accounting standard dealing with the treatment of fees and costs associated with loan origination may encourage mortgage sales, in general, and many of these would be likely to be made servicing-released.

The Financial Accounting Standards Board's Statement Number 65 allows a firm that retains the servicing on mortgages it sells to recognize into income the difference between the stated servicing fee (as stated by the investor) and the servicer's normal servicing fee. In response to questions regarding what constitutes normal servicing fees, the staff at the Financial Accounting Standards Board issued Technical Bulletin 87-3 as guidance (effective for transactions on or after Dec. 31, 1987). Technical Bulletin 87-3 defines a normal servicing fee to be the amount paid to servicers by the secondary market agencies for mortgage loans (Fannie Mae, Ginnie Mae, and Freddie Mac). Reportedly, some industry participants believe that the standardization of a normal amount for a servicing fee reduces the incentive for keeping servicing when the originator sells the loans because it reduces the amount of excess income that can be recognized immediately at the time of the sale. Thus, this guidance was viewed as an incentive to sell mortgages servicing-released.

Also effective at the same time as this guidance was an accounting change for loan origination fees and costs (Financial Accounting Standard Board's Statement Number 91). Some believe this accounting change caused an increase in mortgage loan sales. Specifically, the accounting changes that may have encouraged the sale of mortgage loans are the following:

- The requirement to monitor actual payments, and if differences have arisen between the original calculations and actual results, to recalculate

anticipated future payments. This increased the burden for administering the loans.

- Prohibited recognition of origination fees in current year income. In effect, the accounting change increased the amount of origination fees (net of cost required to be deferred and amortized over the life of the loan), thus having a tendency to reduce current year net income.
- The requirement to recognize commitment fees over the life of the loan.[1]

Therefore, one way to reduce the administrative burden and to recognize deferred fee income sooner is to sell the loan. Because many loans are sold servicing-released, to the extent that these changes in Statement 91 encouraged mortgage sales, they would have also caused an increase in the transfer of servicing rights. In addition, some experts believe that the accounting change would result in portfolio-swapping because both the seller and the buyer can benefit from the accounting treatment without significantly changing the composition of their portfolios.

Some Lenders Do Not Service Any Loans

Many mortgage bankers only originate loans and sell everything that they originate. Other firms do not originate loans and concentrate only on servicing. Thus, the increasing servicing transfer volume may be, in part, a reflection of what industry experts have noted as a trend toward greater separation of the origination and servicing sides of the business.

Why Firms Buy Servicing

Servicing is sought for the high yield that it provides—a yield that may be higher than that provided by other investment alternatives. Several factors interact to make servicing a profitable venture. Among these are favorable tax treatment, access to monies held in escrow accounts for the mortgages serviced, economies of scale, and others.

Tax Advantages for Purchased Servicing

Purchased servicing offers a tax advantage that originated servicing does not. Originated servicing and purchased servicing provide their owners with a steady income; however, purchased servicing is also considered a depreciable, intangible asset for tax purposes (like any other intangible business asset with an estimable useful life, such as patents and copyrights).[2] We identified three court cases that have examined

[1]The Financial Accounting Standards Board defines commitment fees as "fees charged for entering into an agreement that obligates the enterprise to make or acquire a loan or to satisfy an obligation of the other party under a specified condition."

[2]Section 167(a) of the Internal Revenue Code and Treasury Regulation, Section 1.167(a)-3

this issue and found that, generally, the right to service mortgages meets the criterion to be considered an intangible business asset that may be depreciated.[1]

Access to Escrow Funds Provides Benefits to Servicers

Servicers have access to escrow funds (property taxes and insurance premiums) on which they may not be required to pay the borrower interest. Servicers may deposit these funds in interest-bearing accounts or, alternatively, in non-interest-bearing accounts with the lenders that provide their lines of credit. In the latter case, the lender may provide the line of credit at a more favorable rate than would otherwise be offered. To indicate how important access to escrow funds is, a trade journal reported one mortgage servicing broker's estimate that, if the Federal Housing Administration (FHA) implements a new procedure that would reduce amounts that can be held in escrow, the value of some portfolios would drop by 25 to 45 percent. An official of the Department of Housing and Urban Development agreed that such a change would have a "devaluing" effect on existing portfolios. However, he doubted that the impact would be as great as indicated by the mortgage servicing broker.

Economies of Scale Exist for Large Servicing Operations

Economies of scale play an important role in a servicer's decision to acquire additional servicing. According to trade publications, automation has made it possible for some firms to achieve a very low per-unit servicing cost, but the servicer must handle a large number of mortgages to afford the new technology. During periods when originations are down, it may be necessary to buy additional servicing in order to realize these economies of scale. However, some industry participants see a limit to the number of mortgages that can be efficiently serviced in one operation. An economist with a major servicing broker observed that economies of scale do not improve beyond 80,000 loans serviced. Similarly, the president of one large servicing operation suggested that economies of scale exist only up to about 100,000 loans.

[1]Western Mortgage Corporation v. United States, 308 F. Supp. 333 (C.D. Calif. 1969); Securities-Intermountain, Inc. v. United States, 70-1 U.S. Tax Cas. (C.C.H.) 9268 (D.Ore. 1970); and First Pennsylvania Banking and Trust Company v. Commissioner of Internal Revenue, 56 T.C. 677 (1971).

Servicers Market Other Services to Borrowers in Their Portfolios

A secondary benefit of acquiring servicing is the list of borrowers in the servicing portfolio. This list of borrowers can serve as a mailing list for cross-selling purposes—that is, to market other mortgage and non-mortgage financial services that the buyer may offer. Although some mortgage servicing brokers tend to downplay the benefits that can be derived from cross-selling, others cite it as a factor that may lead some lenders to retain servicing.

Other Reasons to Buy Servicing

Other reasons exist for purchasing servicing. A servicer may buy servicing in order to diversify its servicing portfolio to reduce its overall delinquency rate. For example, if most of the loans in the portfolio are for properties located in depressed areas, the servicer can lower the overall default risk by purchasing servicing for properties located in areas with lower delinquency rates. Or, lenders may sell servicing on the parts of a portfolio that they are not set up to handle—government-insured loans, for example—and purchase the type of servicing that they handle most efficiently.

Servicing Transfers May Occur Under Other Circumstances

Finally, servicing may also be transferred when an institution is placed under conservatorship or receivership. For example, the Mortgage Bankers Association of America reported in July 1989 that about $45 billion of servicing from institutions held in conservatorship by the Federal Deposit Insurance Corporation was being evaluated for disposition, and one of the alternatives being considered was selling the servicing. To put this figure into perspective, $45 billion of servicing is about 30 percent of all the estimated servicing traded in 1988. Secondary mortgage market agencies may also direct financially troubled servicers to transfer the servicing for mortgages in which the agencies have an interest. In addition, servicing transfers may occur in large volume when one institution takes over another institution that has an existing servicing portfolio.

Servicing Transfers May Create Problems for Borrowers

Trade journal articles that discuss the benefits of trading servicing sometimes mention its downside: Borrowers blame a variety of servicing problems on the transfers. Among the kinds of problems that borrowers associate with servicing transfers are the assessment of late fees during the transfer period, difficulties in communicating with the servicer, and disputes over the administration of the escrow account (including increases in escrow amounts and the late or nonpayment of taxes and hazard insurance premiums).

Anecdotal evidence of the problem is compelling. Problems, and the frustration they cause, have been described in newspapers, magazines, and trade journals. For example, one newspaper article reported the experience of a borrower who, in trying to resolve a dispute with his new servicer, spent more than $100 on telephone calls because he could not get through on the servicer's toll-free number.

No central source of information exists on the magnitude of these problems. Federal regulatory agencies have some evidence of the problem, but they do not specifically track whether complaints about servicing are related to a transfer of servicing. A review of the complaints in the categories that might be related to servicing transfers revealed few complaints were transfer-related. At the state level, however, some officials have received enough complaints that they characterize transfer-related problems as widespread.

Syndicated Column Generated Hundreds of Complaint Letters

A large group of borrower complaints related to servicing transfers came in response to an April 1989 syndicated column by real estate columnist Kenneth Harney. The column, which appeared in about 100 newspapers across the nation, suggested that borrowers whose service had been transferred write to Representative John J. LaFalce about their experiences. A copy of the column appears as appendix V.

As a result of the column, 605 borrowers, as well as several attorneys, realtors, and mortgage banking personnel responded. Thirteen of the borrowers reported that there were no difficulties associated with their transfers. The remaining 592 persons reported a total of 1,705 different complaints related to the transfers. That is, most borrowers had more than one problem with the transfer of servicing. For example, one borrower reported that he spent 15 months trying to resolve a series of problems that included insurance cancellation, unwarranted late notices, and late payment of taxes.

Table III.1 categorizes the nature of the complaints reported in this group of letters. The experiences of this group cannot be projected to the universe of borrowers whose service has been transferred because the information was not obtained in a statistically valid manner to give appropriate weight to transfers that were accompanied by problems versus those that were not or to categorize the different types of problems.

Table III.1: Borrower Complaints Related to Servicing Transfers

Type of Complaint	Number
Dispute over changes in the escrow account	289
Failure of servicer to respond to borrowers' inquiries	279
Difficulty in reaching servicer by telephone	261
No advance notice or inadequate advance notice of transfer	137
Improper posting of payments	129
Taxes not paid in a timely manner	113
Insurance premiums not paid in timely manner	101
Other escrow problems	99
Assessment of late fee because payment was sent to the old servicer	82
Payment coupon books not sent to borrower	61
Other complaints related to transfers	154
Total	**1,705**

In addition, 46 respondents mentioned that they had deliberately selected the financial institution where the loan was originated because of its proximity or because they had other business with the institution.

The numbers shown in table III.1 indicate, at least for this group of borrowers, which type of servicing transfer problems are most prevalent. For example, of the 605 borrowers who wrote, almost 48 percent had complaints about escrow increases, and over 46 percent complained that the servicer did not respond to their inquiries in a satisfactory manner.

In the following sections, judgmentally selected cases from the group of letters sent to Representative LaFalce are presented to illustrate the types of difficulties that some borrowers have had and others could have when their servicing is transferred. Whether these experiences are typical among borrowers whose servicing is transferred is not known. Further, we have not independently substantiated the claims and allegations of the writers.

Escrow Increases and Shortages Were Sizeable and Unanticipated by the Borrower

Disputes over changes in escrow accounts appeared as the single most frequent complaint in the group of letters. This category included changes to monthly payments and shortfalls in the required escrow reserve. Of course, increases in taxes and insurance premiums and shortfalls in escrow accounts may necessitate escrow adjustments; however, many borrowers in this group complained of what they believed to be unjustifiably large increases.

For example, following the transfer of servicing on her mortgage, a New Jersey homeowner saw her monthly payment increase from $608 to $917.53—an increase of over 50 percent. The new servicer explained that this increase was to cover tax increases. The borrower disputed the need for such an increase because, using her taxes from the previous year, she estimated that the new amount would result in an escrow excess of about $2,000. Reportedly, the only explanation provided by the servicing representative was that the amount to be escrowed for taxes was based on a legal formula that all banks use. The homeowner predicted that she would probably be forced into default because of the increased payment.

Servicers Were Unresponsive to Borrowers' Inquiries

This category includes complaints that the servicers were indifferent and unresponsive to the borrowers' problems. Allegations are that the servicers did not respond to written complaints (even when certified mail was used), would not put anything in writing, and would not send documentation such as payment histories, escrow analyses, or tax information. A borrower in California wrote that it took the new servicer 5 months to respond to a written request for an itemized statement of the account. Another borrower reported that, after waiting more than 2 months for a response to her written inquiry regarding a late notice, she called the servicer and was told by a servicing representative that she should be patient because there were "thousands of complaints" like hers.

Telephone Communication With the New Servicer Was Difficult

For a variety of reasons, borrowers found it difficult to communicate with their new servicers. Servicers were faulted for not having toll-free numbers or for having toll-free numbers that were constantly busy. Borrowers also complained of being kept on hold for long periods, of only being able to reach a computer (rather than a servicing representative), or of having to deal with rude, unhelpful, or unknowledgeable servicing representatives.

This homeowner's complaint was fairly typical of those in this category:

"It was much easier dealing with the local mortgage companies. Although the out-of-state mortgage companies provide toll-free numbers, their lines are frequently busy. If by chance you get through, you are placed on hold for an inordinate amount of time and then usually told that the person you need to speak with is not available."

A similar complaint came from another homeowner:

"It is almost impossible to talk to [a representative of the new servicer] about our mortgage concerns....[T]hey do have an 800 number, but it is almost always busy, no matter what time of day I call. When the line is answered, I am always put on hold, often for more than fifteen minutes at a time. When a human finally does come on the line, it is some sweet young thing that knows absolutely nothing and has no authority to even answer questions. A very frustrating situation when one has to call from work." [Emphasis in original.]

Servicers Did Not Provide Timely Notice of Transfers

This group of borrowers complained that notice of the transfer was received too late or not at all. Others were concerned about the possibility of fraud because they received notice of the transfer from the new servicer, but no confirmation from the old servicer. Still other borrowers were angry because they were not consulted about the transfer and had no choice in the matter. A borrower from Florida wrote,

"I received no advance notice of the change in servicing, much less any explanation....If I were to have a choice between a lender who would keep the mortgage locally and one who might sell it, there is no question that I would opt for the local choice. Once the large, impersonal "servicing" companies get a mortgage, the consumer becomes just a number in a computer program and is really "set up" for long distance problems in communications which are, at best, difficult and time consuming to deal with." [Emphasis in original.]

Payments Were Not Properly Posted to Accounts

Borrowers complained that their new servicers did not properly credit their monthly payments. More specifically, borrowers contended that servicers took too much time to process their payments, so that the payments were posted after they had become delinquent and late fees could be assessed. Some borrowers were assessed late fees even though they had cancelled checks to prove that payment was made on time. For example, a borrower in Arizona said that her new servicer refused to remove a late charge even when provided copies of the cancelled check that showed that the disputed payment had actually been deposited by the servicer before the payment due date.

In another case, the homeowner wrote that since the transfer of her mortgage in September 1988, she has been unable to have her payments properly credited to her account. As a result, she received a notice of intention to foreclose. By telephone, the servicer told her to disregard the letter warning of the foreclosure proceedings because the matter had been corrected. The borrower claims to have never received a letter confirming this, although the servicing representative promised to send such a letter.

Taxes Went Unpaid or Were Not Paid in a Timely Manner

Many borrowers complained about the payment of their taxes from their escrow accounts. Specifically, the borrowers complained that their taxes had not been paid on time or had not been paid at all by the servicer. For example, a homeowner in Oklahoma (whose mortgage was sold twice in 1 year) received notice that her taxes had not been paid. She wrote, "It took three months of letters and long-distance phone calls to finally get our taxes paid. My husband and I feel very helpless and frustrated that we have no say-so in who services our mortgage account." In some of the cases, the borrower reported that when the servicer finally paid the taxes, penalties required by the taxing authority were deducted from the borrower's escrow account.

Insurance Premiums Were Not Paid; Coverage Sometimes Lapsed

As with taxes, borrowers complained that servicers sometimes failed to make timely payment of hazard insurance premiums for which funds were escrowed. In some cases, borrowers paid the premiums themselves and then had to try to recover the money from the servicer. In one case, after failing to pay the insurance premium to the original insurance company, the servicer obtained much more expensive coverage through another firm. That action provoked this letter to the servicer:

> "The premium for [the new] policy is...$915.00 for coverage which is not comparable to the coverage [of the other policy] for less than one-third the cost....It is absolutely outrageous to fail to pay funds from an impound account and then utilize your failure as an excuse to place coverage elsewhere at a grossly inflated price." [Emphasis in original.]

In other cases, the insurance coverage actually lapsed, leaving the property unprotected. One homeowner wrote that, following the transfer of her servicing, her insurance coverage lapsed without her knowledge because the premium had not been paid. This occurred because neither the old nor the new servicer ever notified the insurance company of the

change. Consequently, the new servicer was never billed. The homeowner found out about the lapse when she filed a sizeable claim ($21,000) under the policy. No one accepted responsibility for the lapse of coverage. Ultimately, the homeowner and her family filed for bankruptcy and lost the home through foreclosure. The homeowner blamed this outcome on events related to the servicing transfer.

Late Fees Were Assessed Because Payment Was Sent to the Wrong Servicer

Borrowers complained that, during the period when their servicing was being transferred, they were assessed late fees either because they were notified of the transfer after payment had been mailed to the old servicer or because the transfer notice did not tell them the correct address for payments. In other cases, the transfer notice was sent prior to the effective date that payments were to be mailed to the new servicer, but so much advance notice was provided that the borrower mailed payments to the new servicer that should have gone to the old servicer.

One borrower whose servicing was transferred in January 1988 wrote,

"During the third week in February, I received a notice that my February 1 payment had not been received by [the new servicer]. I called their toll-free number (which required numerous tries because the number is usually busy) and was told by a customer service representative that I should not worry about the notice unless I got another one because the computers had not yet caught up with all of the new loans. After receiving two more notices, I called again during the second week in March and was told that not only had my February payment never been received, my March payment was also delinquent. I had received my cancelled check for my February payment back from the bank at that point, so I agreed to mail a copy of the cancelled check to [the new servicer] in an attempt to solve the problem. Three weeks after I mailed the copy of the check, I was still receiving past-due notices (which stated that I owed in excess of $2,000 in payments, late fees, and additional interest) so I called [the new servicer] again. The customer service representative told me that they had received the copy of my check but that they could not credit my account until they found out where they had deposited my funds.

"I do not believe that [the old servicer] provided adequate notice of the transfer, nor do I believe that [the new servicer] took the necessary steps to ensure that it was properly prepared to handle the extra steps to initiate the new loans.... Also, I believe that once I provided a copy of a cancelled check showing that the payment had been made, my account should have been credited immediately and that any problems with the resulting bookkeeping should have been the problem of [the new servicer]."

Servicers Were Slow to Provide Payment Coupon Books

Some of the complaints in this category were from borrowers who were bothered that they were not sent new payment coupon books for a long period of time after the servicing was transferred. Others complained that they were sent multiple coupon books with conflicting monthly payment amounts. For example, within the period of 1 week, a homeowner in New York received four new coupon books with three different monthly payment amounts.

Real Estate Attorneys and Others Reported Problems Related to Transfers

Most of the persons who wrote to Representative LaFalce about problems were borrowers. However, attorneys, mortgage banking personnel, realtors, and others also cited concerns. Attorneys complained that the transfer of servicing caused problems at settlement because documents are lost during the transfer process or because payoff balance information was incorrect or difficult to obtain. One attorney wrote:

"It has been our experience time and time again to run into great difficulty in obtaining payoff figures for satisfaction of the mortgage being serviced; and, even more difficulty, after payoff of the mortgage, in obtaining the original document for cancellation.... After months of telephoning and letter writing, we are usually told the original document cannot be found." [Emphasis in original.]

Another attorney wrote:

"Our firm represents homeowners and small property owners in New York City and Nassau County and we are involved in many areas of mortgage financing on behalf of borrowers. I have yet to see a transfer of mortgages between two institutions be handled without an administrative snafu in connection therewith and in each occurrence such snafus have always been to the detriment of the borrower. Probably the most detrimental item to a borrower comes from the new mortgagee's demands for substantial increases in the mortgage escrow balances after the switch."

The branch manager of a mortgage banking company wrote:

"The manner in which mortgage companies treat mortgage holders is appalling.... I have tried to help many, many people who have indeed had the type of problems you describe. It is impossible for me to put into words the frustration and the anger I feel over this problem. What is happening is totally unfair and I believe unethical."

From a realtor in Texas:

"Yes, mortgage companies are a nightmare!

"Loans are sold so frequently that many times the new company is not prepared to service the new loans. Payments are not promptly applied, then causing endless discussions about late fees. Checks and coupons are separated and payments are not applied for weeks nor is any effort made to contact the writer of the check to ascertain where the payment belongs.

"Checks sent in for payments on multiple loans are applied all to one loan leaving the others delinquent. Payments are not made on insurance policies, thus enabling the mortgage company to put their insurance into effect—at a much higher premium, of course.

"It is costing the consumer big bucks in long distance calls and postage not to mention time to unravel these mistakes. As a professional in the real estate business with sixteen years experience, it is sometimes almost more than I can accomplish because of the lack of cooperation, inefficiency, and lack of caring of the companies. I don't know how the average homeowner copes."

Finally, one homeowner's transfer experience led her to co-found, with the help of the wife of Utah state legislator Frank Prante, a group called Help Save Homes. She reported that,

"Because of my family's experience I was compelled to find other people that had also been the victims of mortgage abuse. I copied names from newspapers, and the foreclosure board at the courthouse. Finally I copied hundreds of names from the assignment list at the county recorder's office. As I started to call these people...I came to the realization that we were dealing with an unbelievably widespread problem.... We, through our group, are trying to balance the scales, and give homeowners a voice, and give them their rights back.... We are receiving calls and letters from concerned and distressed homeowners from several states."

Representative Prante also wrote, stating,

"The significant problems experienced by not only my constituents, but by myself as well, have drawn me into the issue [of the selling of mortgage servicing].... I am currently developing state legislation to help protect homeowners in dispute with their mortgage companies.... I am very concerned that most of the problems relate to the selling of mortgage servicing, especially out of state."

Regulatory Groups Do Not Track Whether Servicing Problems Are Related to Servicing Transfers

Depending upon the type of institutions involved in the servicing transfer, borrowers who wished to do so could direct their complaints about servicing transfers to the Federal Home Loan Bank Board, the Federal Trade Commission, the Federal Reserve, the Office of the Comptroller of the Currency, or possibly some other agency. In addition, complaints might be brought to the attention of various state officials.

In general, these agencies do not track complaints related to servicing transfers in a way that facilitates their ready identification as such. Instead, the complaints are generally categorized by the nature of the complaint itself and thus would be counted as an escrow problem, a late payment, or some other type of problem.

Although borrower complaints were not readily identifiable as transfer-related, agency officials did review information in their files to try to ascertain the nature and order of magnitude of the problem. This review revealed that a relatively small number of the complaints were related to servicing transfers. The following sections present the detailed results of those reviews. The format of these sections varies, depending upon how the agency provided the data to GAO.

The Federal Home Loan Bank Board

The Federal Home Loan Bank Board reported on borrowers' complaints lodged against savings and loans insured by the Federal Savings and Loan Insurance Corporation. Complaints reviewed were those received in 1988 and the first quarter of 1989. Officials at each of the 12 district banks reviewed complaints in 4 categories that were potentially related to servicing transfers. These categories were: (1) loan—late payment; (2) amount of escrow collected; (3) payment/nonpayment of escrow; and (4) other escrow problems.

During the 15-month period, of a total 9,413 written complaints systemwide, 1,786 (about 19 percent) were within the 4 categories considered to be potentially related to servicing transfers. In 1988, 557 complaints received and resolved were related to the payment/nonpayment of taxes and insurance alone. In 56 percent of those cases, an institution had committed a violation or error.

Bank Board officials asked each of the 12 district banks to review a sample of complaints in the 4 categories. The results by district follow.

District I (Boston)

Six of the 81 complaints appear to have resulted directly from the transfer of servicing. All of the six required adjustments, four of which were

monetary and two non-monetary. Five of these complaints were against the same institution, which had acquired the servicing of a failed thrift and a service corporation during 1987 and 1988, respectively. During the period in 1988 when the 25,000 loans involved were computerized, there were many complaints were about late payment charges and escrow problems.

District II (New York)

New York had a total of 725 complaints within the 4 categories, of which 470 (about 65 percent) were reviewed to determine whether they were related to servicing transfers. Of these 470, 55 (about 12 percent) were the direct result of the transfer of servicing.

District III (Pittsburgh)

Pittsburgh received a total of 31 complaints within the 4 categories, of which a "limited" number involved the transfer of servicing.

District IV (Atlanta)

During the period reviewed, Atlanta received 113 servicing complaints associated with the transfer of servicing. These 113 complaints accounted for 46 percent of all loan complaints received. Of the 84 complaints that have been resolved, 21 (25 percent) were determined to have involved a violation or error by the institution.

Eighty-three of the 113 complaints were against 2 institutions. The problems associated with one of those institutions were the result of a management decision to assess a "cushion" equal to 16 percent of funds collected for escrow on all escrow accounts. In the case of the other institution, the complaints were primarily about late charges erroneously assessed, escrow account overages, and the assessment of penalties against the borrower for the institution's negligence in failing to pay taxes in a timely manner. Eighty-two percent of the 169 complaints against this institution were resolved in favor of the complainant, and 25 percent of these involved a monetary adjustment by the institution.

District V (Cincinnati)

Cincinnati identified 46 complaints in the 4 relevant categories. Of these, 13 (about 28 percent) pertained to the transfer of servicing. Most of these problems were related to escrow problems (shortages, misapplication of funds) and the nonpayment of taxes and insurance. In one case where escrow payments were misapplied, the institution reimbursed the customer's escrow account by over $9,000.

District VI (Indianapolis)

This district identified 38 transfer-related complaints. Among the complaints were the following: nonpayment of taxes; double payment of taxes; nonpayment of insurance premiums; assessment of late fees

against the borrower when the servicer paid the taxes late; and other escrow problems.

District VII (Chicago)

None of the 86 complaints in these 4 categories were associated with the transfer of servicing.

District VIII (Des Moines)

Des Moines indicated that servicer-related complaints did not appear to be a serious problem in the District. Only 17 cases involved late charges and escrow problems, and only 3 resulted from servicing changing hands. Escrow complaints seemed to occur at the time that escrow analysis was completed. People who complained about late charges, whether or not servicing was transferred, were usually those who waited until the fifteenth of the month to make their payments.

District IX (Dallas)

Three borrowers complained about problems associated with servicing transfers. None of the complaints, however, resulted in a finding of violation or error on the part of the servicer.

District X (Topeka)

Topeka identified 38 complaints within the 4 categories. Of these, eight were associated with the transfer of servicing. Five cases were referred to the District in which the servicer's headquarters was located. In two of the remaining cases, reimbursements were made to the borrower. In the last case, the institution was not found to be in violation of federal regulations, and no adjustment was made.

District XI (San Francisco)

Of San Francisco's 172 servicing complaints, 41 were about the payment of taxes by the same institution. The problems began after the institution acquired an institution in another state. The same institution experienced the same problems after acquiring another out-of-state institution. The institution blamed the problems on its tax service, and claimed that such problems are usually resolved after 6 to 12 months. However, the District Bank began to receive complaints from the same borrowers for the second time. No supervisory action has been taken against the institution because it paid the taxes and penalties.

Another institution began to have complaints about the nonpayment of insurance premiums after it acquired an out-of-state institution. The problems, however, do not appear to be recurrent.

About 50 complaints last year occurred because borrowers were not told where to send payments following the transfer of servicing. However, the District Bank attributed the problem to the subsequent servicer and not to the institution that had sold the servicing.

District XII (Seattle)

Seattle identified nine complaints that fell into one of the four categories. These were related to the payment of taxes or insurance, or other escrow issues. In four of these cases, the problems were attributable to the seller of the servicing, not the buyer.

In general, the Bank Board has found that, in cases where one institution has acquired another, servicing takes approximately 6 to 12 months to run smoothly. In the case of one institution, problems were so acute that the Bank Board disallowed the purchase of additional servicing until the problems were resolved.

Finally, the Bank Board told us that,

"We are aware that the consumer finds problems associated with the transfer of...servicing rights extremely frustrating. However, based on our research, the problems associated with the sale of either mortgages or of servicing rights are not as pervasive as...we might have presumed."

Federal Trade Commission

The Federal Trade Commission (FTC) handles borrower complaints about mortgage servicing provided by mortgage bankers. The complaint-tracking system used by FTC does not track whether mortgage servicing problems are associated with the transfer of servicing. Therefore, the information provided by FTC, and summarized in table III.2, is for any mortgage servicing complaint received by FTC.

Table III.2: Complaints About Mortgage Servicing Received by the Federal Trade Commission From 1986 to June 1, 1989

Year	Number of complaints
1986[a]	86
1987[a]	224
1988	215
1989[b]	157
Total	**682**

[a]For 1986 and 1987, some FTC offices no longer had records of complaints.

[b]Through June 1, 1989.

In addition to the information shown in table III.2, an attorney who deals with these complaints in FTC's Division of Credit Practices provided impressions about mortgage servicing problems, both related and unrelated to servicing transfers. According to the attorney, in recent months more of the complaints seem to be related to servicing transfers. She believes that servicing problems are widespread because of the

unregulated nature of servicing among mortgage bankers and that problems are merely compounded by the transfer of servicing. Some servicers have told her that problems occur when they acquire large blocks of servicing because it takes time to load everything into the computer system. Her experience is that the bulk of the servicing complaints fall into one of the following categories:

- Escrow accounts. This is probably the principal problem associated with mortgage servicing transfers. Escrow calculations often lead to amounts that are much greater than what was being collected by the previous servicer. In addition, the attorney reported cases where, after the transfer, the borrower received three different coupon books with three very different calculations of escrow amounts.
- Nonpayment of taxes and insurance. These complaints are not necessarily associated with the transfer of servicing. The attorney speculated that servicers make these payments late because of the interest they can earn by holding onto the funds held in escrow.
- Communication. The attorney also views this problem as a systemic one, not solely associated with the transfer of servicing. The cause of these communication problems is that servicers have inadequate servicing personnel to staff their toll-free phone lines.
- Late fees. Again, this problem appears to be associated with servicing in general and results because the borrower is usually unable to prove when the servicer received the payment. Also, the late notices generally do not specify for which month a payment is delinquent so the borrower cannot tell when the delinquency originated. In addition, some borrowers have become delinquent in their accounts while awaiting the receipt of new coupon books because they believed that the coupon must accompany their payment.

Federal Reserve System

The Federal Reserve Board has supervisory responsibility for state-chartered banks that are members of the Federal Reserve System. The Division of Consumer and Community Affairs of the Federal Reserve System reported that, in the 15-month period from January 1, 1988, through March 31, 1989, a total of 2,733 complaints were received. While the Federal Reserve's complaint tracking system does not have a specific code for complaints about mortgage servicers, the staff were able to recall 12 mortgage servicing complaints that involved a change

in the mortgage servicer. The 12 complaints fell into the following categories: assessment of late fees (4); escrow account administration (2); improper or untimely posting of payments (1); failure to respond to a borrower inquiry (1); no advance notice of the transfer (1); change in the terms of the contract regarding private mortgage insurance (1); and other complaints (2).

Office of the Comptroller of the Currency

The Office of the Comptroller of the Currency has regulatory authority over national banks. Like the other regulatory groups, it has no specific category in its complaint-tracking system for transfer-related complaints. Therefore, officials looked at complaint categories and subcategories that would be likely to capture such complaints: payment history issues, late payments, payment problems, refusal to provide accounting, failure to respond to requests for information, and escrow issues. For the 28-month period from January 1, 1987, through June 1, 1989, the Office of the Comptroller of the Currency reported 676 potentially relevant servicing complaints of the approximately 34,000 total complaints received.[2] However, to the best of the recollection of agency officials, very few of these complaints were related to the transfer of servicing.

Federal Deposit Insurance Corporation

Complaints against state-chartered banks that are not members of the Federal Reserve System would have been directed to the attention of the Federal Deposit Insurance Corporation. However, officials there could not recall receiving many complaints about mortgage servicing transfers or even about mortgage servicing, in general.

State Agencies

Among the 31 states that provided information on complaints related to servicing transfers, we found considerable variation in the number of complaints brought to the attention of state officials. For example, no complaints related to servicing transfers have been received by the Consumer Fraud and Antitrust Division in North Dakota's Office of the Attorney General. In Missouri, the Division of Finance reported receiving 75 to 80 complaints per year associated with servicing transfers.

[1]Of the 2,733 complaints, only 989 involved banks that are members of the Federal Reserve System. In addition, of the 12 complaints involving a change in servicers, only 2 involved member banks.

[2]The Northeastern District only reported complaints received in calendar year 1988.

The Deputy Attorney General, State of California, provided some detail on the types of complaints being brought to the attention of that office. For example,

"Payment coupons are not included [with the notice of transfer] and the homeowner is not sure when, to whom, where, or how to make the subsequent payments. Homeowners find it difficult to obtain this information because the notice often does not tell them who to contact if they have any questions. They are often transferred around from department to department and from person to person."

The Deputy Attorney General noted that about 400 complaints have been raised against the same servicer over the past several years, and that these complaints were usually associated with the initial transfer of the servicing. In some cases, the checks sat around for months, and late notices were generated, even in cases where the borrower had certified mail receipts showing that payment had been received by the servicer. The Deputy Attorney General also described difficulties in reaching servicers' toll-free numbers and the lack of adequate, trained servicing personnel to answer borrowers' questions.

Many of the state officials believed that servicing transfers cause problems for borrowers, and some of the officials characterized the problem as one that is widespread. For example, an investigator in the Consumer and Business Fair Practices Division, Office of the Attorney General, State of Washington, reported that, although the division's complaint-tracking system does not segregate complaints that are transfer-related, "complaints about mortgage servicing have increased dramatically as the practice of selling loans, and/or servicing rights has increased." Complaints against one company increased by nearly 300 percent after the transfer of a large block of servicing.

An Assistant Attorney General from Nebraska wrote:

"I perceive mortgage servicing transfers...as a significant consumer problem, largely because of the dearth of laws adequately treating this subject. For better or worse, a mortgage is an expense that many consumers will incur in their lifetimes, yet the practices in this industry are still largely controlled by the whim or the profit of the company handling the accounts.... My thought in resolving this problem is that only significant legislative reform will adequately address it. That reform must include notice provisions to consumers, plus arbitration proceedings for a disputed hike in monthly charges and very specific language telling mortgage...servicers how they may collect their debts."

Magnitude of the Problem Remains Unknown

No central clearinghouse exists for borrower complaints related to mortgage servicing. Thus, how extensive the problem is remains unclear. The relatively low number of complaints reported to us by federal regulatory groups might lead to the conclusion that transfer-related problems are not widespread; however, another possible conclusion is that borrowers with problems may not know whom to contact. In addition, consumer research shows that consumer complaints received usually represent only "the tip of the iceberg." Finally, most of the regulatory officials who provided information to us mentioned that their consumer complaint-tracking systems lack a specific code to allow the identification of complaints associated with the transfer of servicing. Instead, the complaints were usually categorized by the type of problem involved, e.g., escrow, late payment, or some other problem.

Servicing Problems Also Occur When Servicing Is Not Transferred

Many of the complaints that borrowers may associate with a servicing transfer may not necessarily be the result of the transfer process but may instead be a case of generally poor servicing. Borrowers whose servicing was not transferred had similar complaints about increases in escrow amounts or about the late or nonpayment of taxes or insurance premiums. Thus, while servicing problems may occur when servicing is transferred, there may not always be a cause-and-effect relationship between the two. Still, when problems do occur, resolution may be more difficult with a servicer located in another state rather than one in the local area. An official of one of the secondary market agencies told us, "If you have a good servicer, it doesn't matter where he is. If he's a lousy servicer, then it's best if he's in your back yard because you're going to be spending a lot of time with him."

Some Actions to Address Servicing Transfer Problems Have Been Taken

Despite a lack of information on the extent of problems associated with servicing transfers, a number of actions have already been taken that could help to minimize transfer-related problems. These actions include state legislation, guidance from the secondary mortgage market agencies, and trade association standards. In addition, at the federal level, legislation designed to protect the borrower has been proposed.

State Laws Address Servicing Transfers

We identified 12 states that have laws or regulations that specifically address transfers of mortgage servicing. The provisions vary from state to state, but they are generally designed to ensure that borrowers receive adequate notice prior to the date that the first payment is due the new servicer. Two of these states require disclosure, prior to loan closing, that servicing is subject to transfer. Additionally, at least five of the states provide for monetary penalties for failure to comply with the state servicing transfer laws. For example, in Wisconsin, a lender who violates the law may be liable to the borrower for $500, plus actual damages, costs, and reasonable attorney fees. A summary of the key provisions of these laws and regulations is included as appendix VI.

FHA Regulations Direct Notification of Borrowers

FHA regulations direct the transferror of servicing on FHA-insured mortgages to mail a transfer notice to the borrower to reach the borrower not later than 10 days prior to the due date of the first payment to the new servicer. In addition, the transferror must provide the mortgagor with the name, address, and telephone number of the new servicer and include any special instructions for the handling of payments during the transfer period. According to an official of the Department of Veterans Affairs, there are no similar requirements for mortgages guaranteed by that Department.

Secondary Market Agencies and Mortgage Bankers Association Issued Transfer Guidelines

The Federal Home Loan Mortgage Corporation (Freddie Mac) has established guidelines for servicers who transfer mortgages in which Freddie Mac has an interest. In short, the guidelines require that the transferror provide the borrower "timely notice" of the transfer. However, what constitutes timely notice is not stated. The notice to the borrower must include information on the effective date of the transfer, how to contact the new servicer, when the borrower should begin to send payments to the new servicer, and the impact on such items as optional mortgage life insurance. The buyer of the servicing must send the borrower written

confirmation of this information prior to the effective date of the transfer of servicing. Finally, the servicing seller must notify third parties (e.g., insurers and tax authorities) of the servicing transfer.

The Federal National Mortgage Association (Fannie Mae) also established guidelines similar to those issued by Freddie Mac. Fannie Mae's guidelines require that the servicing buyer's notice of transfer reach the borrower "generally" at least 15 days prior to the due date of the first payment to be sent to the new servicer. The Government National Mortgage Association (Ginnie Mae) does not have servicing transfer requirements that require notification to the borrower.

In 1987, the Mortgage Bankers Association of America published a set of guidelines for "Effective Transfers of Servicing" that is similar to those established by Freddie Mac and Fannie Mae. These guidelines, which were slightly revised and reissued in September 1988, were developed and adopted by the membership of the association; however, compliance with them is voluntary.

H.R. 1180 Contains Servicing Transfer Requirements, Penalties

Federal legislation addressing mortgage servicing transfers has been introduced in the House of Representatives as H.R. 1180.[1] In many of its provisions, H.R. 1180 is similar to existing state laws. If H.R. 1180 is enacted as currently written, anyone who makes a federally related mortgage loan would be required to disclose to mortgage loan applicants (1) whether the servicing on the loan is subject to sale, (2) the lender's past practices regarding servicing transfers, and (3) whether it is probable that the applicant's servicing would be transferred. Any loan servicer who transfers servicing would be required to notify the borrower of the transfer not later than 10 days prior to the payment due date when payments should be made to the new servicer. Such notification would have to include (1) the effective date of the transfer; (2) the name, address, and toll-free or collect call telephone number of the new servicer; (3) the name (or department) and toll-free or collect call telephone number of an employee of the old servicer who can answer questions about the transfer; (4) the name and toll-free or collect call telephone number of a person employed by the new servicer who can respond to the borrower's inquiries about the transfer; (5) the date that the borrowers should begin to remit payments to the new servicer; and (6) other information. The new servicer would have to provide similar information to the borrower.

[1] 101st Cong., 1st Sess.

In addition, H.R. 1180 would establish a 60-day period, beginning with the effective date of the transfer, during which no late fees could be imposed if the payment were remitted to the wrong servicer. It also would require that servicers respond to a borrower's written inquiry within 20 business days and that payments for which the servicer requires funds to be placed in escrow (taxes and insurance premiums) be made by the servicer in a timely manner.

Finally, H.R. 1180 would establish penalties for failure to comply with any of these requirements.

Article on Servicing Transfers

THE NATION'S HOUSING

Scrutinizing Mortgage 'Servicing'

By Kenneth R. Harney

If you're one of the thousands of American homeowners whose mortgage "servicing" has changed hands in the past several years, a consumer activist congressman from New York has some questions for you.

When your loan was transferred:

- Did you receive adequate notice well in advance, clearly explaining that a new financial institution would be handling your mortgage account, and that monthly payments should be sent to a new location?
- Were there any administrative problems connected with the transfer? For instance, did you find your mortgage account hit with one or more late fees? Were the fees triggered by tardiness on your part or by other factors, such as the late notice you received on how and where to deal with the lending institution?
- Did you experience any unexpected changes in your mortgage escrow balance following the switch in servicers? Did the new servicer raise the amount of escrowed funds required from you every month, thereby raising your mortgage bill? If so, were the increases explained to your satisfaction? Or were you simply told that the new lender's rules require borrowers to maintain higher "reserves" in their account to offset unseen rises in insurance, tax or other escrow items?
- Were you ever put in the position of discovering that your hazard-insurance premiums or any of your taxes were paid late by the new mortgage servicer? Or not paid at all? If so, did that lead to any embarrassments such as warning letters from local governments about possible tax liens or cancellation notices from insurers?
- Did you find communicating with the new mortgage servicer easier or tougher than with the institution that made the loan in the first place? If the new institution was located out of state—often the case—did the distance factor play a role in getting questions answered or your problems promptly straightened out?

The congressman who wants to hear from you is Rep. John J. LaFalce (D-N.Y.), whose district covers Niagara Falls and parts of suburban Buffalo and Rochester.

For months, LaFalce has been hearing from homeowners around the country about problems they've encountered with transfers of their mortgage servicing. LaFalce is a member of the House Banking Committee, which oversees the nation's lending industry.

See HARNEY, F9, Col. 1

GAO Studies Problems In Mortgage 'Servicing'

HARNEY, From F8

Servicing a mortgage means handling all the administrative duties connected with it, such as collecting the monthly payments from borrowers and managing escrowed funds for local property-tax payments, insurance premiums and the like.

Some lenders specialize in servicing for annual fees, and often take over servicing rights from the local lender that originated the loan in the first place.

Transfers in servicing represent a key element in the American mortgage system: An estimated $100-billion-plus of home loans experienced such transfers last year alone.

Lender trade organizations concede that, as in any high-volume business, problems occur in the servicing field. But they insist the problems aren't widespread and are adequately handled under current mortgage-industry guidelines.

LaFalce doesn't think so. He is sponsoring a bill that would toughen disclosure and administrative rules for financial institutions involved in servicing transfers.

He also has succeeded in getting his measure into the housing subcommittee's Omnibus Housing bill of 1989.

Once the banking panel finishes work on bailing out the savings and loan industry, subcommittee members are expected to turn to the housing bill package, possibly late this spring.

In the meantime, LaFalce has asked Congress' watchdog agency, the General Accounting Office, to find out whether mortgage servicing foul-ups are as commonplace as he suspects or whether the lenders are right. The GAO is focusing on the types of situations described above, based in part on LaFalce's files of letters from homeowners, most of whom live outside his district.

A sampling of letters to LaFalce catalogue horror stories of threatened foreclosures for alleged late payments, others describing more routine escrow-account botch-ups.

One Virginia woman who had learned of his legislation sent copies of her two years' worth of wrangling with a large national mortgage company that took over her loan servicing.

The firm insisted on higher monthly escrows than the original lender—illegally as it later conceded in a settlement—and hit her with 24 consecutive late-fee charges. The firm threatened her with foreclosure if she didn't pay $3,000-plus in "arrears" in her escrow account.

A Miami Beach lawyer who oversees 50 mortgages for home-owning clients wrote to say that he had documented that servicing agents routinely "help themselves to late fees from the next-received mortgage payments, thereby shorting" homeowners' escrows without their knowledge or consent.

Using certified mail receipts, the lawyer was able to document that many allegedly late payments were never late at all, but simply recorded late by the servicer. Had he not been vigilant, his clients would have been out large amounts of money.

If you have had any noteworthy experiences relating to mortgage-servicing transfers—good or bad—contact LaFalce at 2367 Rayburn House Office Building, Washington, D.C. 20515.

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Summary of State Laws on Mortgage Servicing Transfers

We identified 12 states that have laws or regulations expressly addressing servicing transfers. All 12 states require notification to the borrower of the transfer of servicing, although not all require this notification be provided by both the seller and the buyer of the servicing, and not all require it in advance of the transfer date. Two of the states have provisions addressing information that must be provided to the borrower at or before the closing of the loan. In addition, five of the states established penalties for servicers who fail to comply with the provisions. Shown below are some of the key provisions of these state laws and regulations.[1] Selected provisions, not directly related to the transfer of servicing, are also summarized for these 12 states.

Alaska (Section 18.56.135)

- The seller must notify the borrower within 10 days after the actual date of the sale.
- Notification must include (1) the name, address and telephone number of the person who will assume responsibility for the servicing and accept payments for the loan; and (2) a detailed, written financial breakdown of the loan, including the interest rate, monthly payment amount, and the current escrow balance.
- The buyer of the servicing must issue to the borrower corrected coupon or payment books, if used.
- Within 20 days after the due date of the first payment to be made to the new servicer, the new servicer must notify the borrower of (1) the name, address, and telephone number of the person from whom the borrower can receive information regarding the servicing of the loan; and (2) changes made regarding the interest rate, monthly payment amount, and current escrow balance.
- Servicers must respond within 15 business days to a written request from the mortgagor for information regarding the servicing of the loan, including in the response the telephone number of the agent's representative who can assist the borrower.
- If the borrower is required to maintain an escrow account to cover taxes or insurance on the mortgaged property, the servicer must make each payment in a timely manner as the obligations become due if funds held in escrow are sufficient to do so. If funds are insufficient, the servicer must promptly notify the borrower of the shortage and may make payment on behalf of the borrower.

[1]This summary should not be used as a definitive source of information on mortgage servicing transfer laws and regulations. It is intended only to show the types of provisions in these 12 states and may not be an exhaustive list. The source of information on statutes for Kansas and Nebraska was State Legislative Compilations, (published by the Mortgage Bankers Association of America) for Kansas and Nebraska. We did not verify the accuracy of this information.

California (1988 Cal. Adv. Legis. Serv. Chap. 1190 (Deering))	• At settlement, the lender must notify the borrower of the responsibility of "the existing servicing agent and new servicing agent" to notify the borrower when servicing is transferred. • The seller and the buyer of the servicing must notify the borrower of the transfer before the borrower becomes obligated to make payments to the new servicer. • Notification to the borrower must include (1) the name and address of the new servicer, (2) the date of the transfer, and (3) the address and due date for future payments. • Borrowers are not liable for payments made to the previous servicer or for late charges if these payments were made prior to the borrower receiving written notice of the transfer.
Colorado (Section 38-38-113 et seq., Revised. Statutes)	• The seller and buyer of the servicing must notify the borrower of the transfer within 20 days of the date of the transfer. Notification must include the name, address, and phone number of the new servicer. • The seller must continue to accept the borrower's payments until the borrower receives notice of the transfer of servicing. The seller must forward to the new servicer any payments received after the transfer. • Servicers must respond within 20 days to borrowers' written requests for information. • Each year, servicers must provide the borrower a summary of activity related to the loan, including the total amount of principal and interest paid on the loan in that calendar year. • Servicers are liable for any interest or late fees charged when taxes, for which funds are held in escrow, are not paid when due. • For any violation of this section, the servicer may be held liable to the borrower for $500, plus actual damages and reasonable attorney fees.
Illinois (Rev. Stat. 1987, Ch. 17, Par. 2323-7 (1989 Supp.)(Smith-Hurd))	• Simultaneous with a transfer of servicing, notice shall be given to the borrower. (It is not stated whether such notice is to be provided by the seller of the servicing, the buyer of the servicing, or both.) • Notification must include (1) where and to whom questions may be directed, along with a telephone number; (2) the name and address of the person to whom payments are to be submitted for at least the next 3 months; (3) the amount of the payment required for at least the next 3 months; and (4) the effective date of the transfer.

Iowa (Code Ann. Sections 535B.1 et seq.. (1989 Supp.))

- Notice of the transfer must be provided by the seller or buyer to the borrower within 5 business days of the transfer of servicing.
- Notification must include (1) the name and address of both parties involved in the transaction, (2) the effective date of the transfer, (3) a statement concerning the effect of the transfer of the terms and conditions of the mortgage, (4) the address where payments are to be submitted for at least the next 3 months, and (5) the name and address of the person to whom questions may be addressed.

Kansas (S.B. 761, Laws of 1988)

- The selling lender of the servicing must notify the borrower of the transfer within 10 business days after the date of the transfer.
- Notification must include the name, address, and telephone number of the person who will assume responsibility for servicing and accepting payments for the loan. If the borrower so requests, the notification must also include a detailed written financial breakdown, including the interest rate, the monthly payment, and the current escrow balance.
- The purchasing lender of the servicing must respond within 15 business days to a borrower's written request for information.
- If the borrower is required to maintain funds in an escrow account, the purchasing lender of the servicing must provide to the borrower an annual summary of all escrow transactions on or before February 15.
- If, through failure to use reasonable care either the selling lender or the purchasing lender fails to comply with the notification requirements, the negligent party is liable to the borrower for $100 per occurrence, in addition to actual damages.

Maryland (Com. Law Code Ann., Section 13-316 (1988 Supp.))

- Within 7 days of acquiring servicing, the servicer must send a written notice to the borrower.
- Notification must include (1) the name, address, and telephone number of the new servicer and the address where mortgage payments are to be forwarded; (2) the principal balance and escrow balance of the loan; (3) the telephone number of a designated contact person to whom the borrower can direct complaints and inquiries; (4) the responsibilities of the contact person; and (5) a statement that a violation of these provisions will result in the servicer being held liable for any economic damages caused by such violation.
- The contact person must respond to a borrower's written complaint or inquiry within 15 days if a reply is requested.
- Servicers are required to make timely payments of taxes and insurance premiums, provided that the borrower has paid an amount sufficient to cover them and the servicer possesses a tax bill or notice.

Minnesota (Stat. Ann., Section 47.205 (1988))

- The "selling lender" must notify the borrower of the transfer of servicing no more than 10 days after the date of the transfer.
- Notification must include (1) the name, address, and telephone number of the person who will assume responsibility for servicing and accepting payments for the mortgage loan; and (2) a detailed, written financial breakdown of the loan, including interest rate, monthly payment rate, and current escrow balance.
- Within 20 days after the first payment is due to the "purchasing lender," the purchasing lender must notify the borrower of (1) the name, address, and telephone number of the person from whom the borrower can receiving servicing information; and (2) any changes in the account or servicing requirements.
- The purchasing lender must issue new coupon or payment books, if used.
- The purchasing lender must respond within 15 business days to a written request for information from a borrower. A written response must include the telephone number of the company representative who can assist the mortgagor.
- Lenders who require borrowers to maintain escrow accounts for the payment of taxes and insurance premiums must make the payments in a timely manner, provided that funds are sufficient for the payment. If there is a shortage, the lender must promptly notify the borrower.
- Lenders are liable to borrowers for actual damages caused by noncompliance with the statutory provisions. In addition, if the noncompliance resulted from the lender's failure to exercise reasonable care, the lender is liable to the borrower for $500 per occurrence.

Nebraska (L.B. 272, Laws of 1989)

- The seller of the servicing must notify the borrower of the sale, in writing, within 10 business days after the transfer.
- Notification must include (1) the name, address, and telephone number of the buyer of the servicing, including the name of a referral person or department; and (2) instructions concerning payments made both before and after the effective date of the transfer.

Virginia (Regulation XI-1, Rules Governing Mortgage Lenders and Mortgage Brokers)

- The borrower may continue to make payments to the seller of the servicing until the borrower receives the seller's written notice of the transfer.
- Notification must include the name and address to which future payments are to be made and must be mailed or delivered to the borrower at least 10 calendar days before the first payment affected by the notice.

Washington (1989 Wash. Legis. Serv. Chap. 98 (West))

- If the servicing for the loan is subject to sale, transfer, or assignment, a lender shall so disclose in writing at the time of or prior to loan closing. This disclosure must also state that when the servicing is sold, the buyer of the servicing is required to notify the borrower.
- If the lender has not provided the notice required above, but later merges with, consolidates with, or is acquired by another servicer and thereafter the servicing is subject to sale, that institution must disclose this possibility to the borrower within 30 days of the merger, consolidation, or acquisition.
- The buyer of the servicing must notify the borrower of a servicing transfer at least 30 days prior to the first payment due date following the transfer.
- Notification must include (1) the name, address, and telephone number of the division from whom the borrower can receive servicing information; and (2) information about any changes in servicing requirements, such as interest rate, monthly payment amount, and escrow balance.
- The buyer must issue to the borrower corrected coupon or payment books, if used and necessary.
- The buyer must respond in writing within 15 business days of receipt of a written request from the mortgagor, including in the response a telephone number of the company division that can assist the mortgagor.
- Any person injured by a violation of these provisions may bring an action to recover $500, actual damages, plus reasonable attorney fees and costs.
- This statute becomes effective on January 1, 1990.

Wisconsin (Stat. Ann. Section 138.052 (1989))

- Lenders are required to notify borrowers in writing if the payment, collection, or other loan or escrow services related to the loan are sold or released.
- Notification must include the name, address, and telephone number of the new servicer and must be delivered to the borrower by mail or personal service within 15 working days after the servicing is transferred.
- Lenders must respond to borrower inquiries within 15 days of receipt of the inquiry.
- Servicers must consider a loan payment by check or other negotiable or transferable instrument to be made on the date that it is physically received.
- The servicer is liable to the borrower for $500 plus actual damages, costs, and reasonable attorney fees unless the violation resulted from an unintentional mistake that the servicer corrected on demand.

Objectives, Scope, and Methodology

Representative LaFalce asked us to examine the practice of transferring mortgage servicing because he was concerned that such transfers were causing problems for borrowers. Specifically, we examined (1) the extent to which servicing is transferred, (2) the reasons for such transfers, and (3) the problems that borrowers may have when servicing is transferred. In addition, we also examined actions taken by certain states, secondary market agencies, and others, as well as pending federal legislation designed to address the transfers of mortgage servicing.

To accomplish our objectives, we interviewed officials of the following public and private organizations:

- the Department of Housing and Urban Development (including Ginnie Mae);
- the Department of Veterans Affairs;
- Freddie Mac;
- Fannie Mae;
- the Federal Deposit Insurance Corporation;
- the Federal Home Loan Bank Board;
- the Federal Trade Commission;
- the Mortgage Bankers Association of America;
- the National Association of Realtors;
- the National Council of Savings Institutions;
- the Office of the Comptroller of the Currency;
- the U.S. League of Savings Institutions;
- various consumer groups; and
- other industry participants and researchers.

Further, at the state level, we contacted the attorneys general to gain their perspectives on and experiences with borrower problems that may be associated with transfers of servicing. We also reviewed state statutes and regulations that govern servicing transfers.

We reviewed relevant documentation, including policies and guidance provided by officials we contacted. Fannie Mae and Freddie Mac provided us copies of the policies that their servicers are to follow when transferring servicing. Similarly, the Mortgage Bankers Association of America gave us its guidance for servicing transfers. The regulatory agencies also provided us information on borrower complaints concerning mortgage servicing that they received.

We also reviewed 605 letters from borrowers whose servicing was transferred. These letters were sent to Representative LaFalce's office in

response to a syndicated column (see app. V) that appeared in about 100 newspapers in April 1989. We were given access to all of the letters and categorized the types of complaints that borrowers described. We did not independently verify the accuracy of the statements contained in the letters, except that we examined supporting documentation (e.g., copies of cancelled checks and correspondence) when such information was provided. Because this information is anecdotal, no generalizations can be drawn about the magnitude of the problem among all borrowers whose servicing is transferred.

In addition, we conducted a literature search to determine what has been reported on problems related to servicing transfers as well as why servicing is transferred. Much of the information on why servicing is bought and sold was obtained from trade publications.

Our review focused on borrower problems and did not include an examination of the benefits that may result from the transfer of mortgage servicing. For example, we did not examine whether mortgage loans are less expensive for the borrower because of servicing transfers or whether, in some cases, servicing actually improves following a transfer of servicing. In addition, we did not determine whether the problems that were reported by borrowers whose servicing was transferred occur among borrowers whose service was not transferred, although we encountered some indications that they do.

Our work was performed between February and October 1989. We discussed the contents of this report with agency officials who generally agreed with the information as presented. As requested, however, we did not obtain agency comments on a draft of this report.

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